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The Manufacturers Hanover
Financial Digest
Economic Commentary, Selected Financial Data, and Business Indicators

MONDAY, JULY 7, 1986 VOLUME XXIII, NUMBER 15

Slack Business Conditions . . .

Despite expectations of a pronounced pickup in global business activity due to such positive economic developments as diminished rates of inflation, declining interest rates and reduced energy costs, the economies of several major industrial countries remain listless. A particular disappointment has been the economic performance of Japan and West Germany, both of which enjoy some of the world's lowest rates of inflation and interest, and were among the key beneficiaries of the plunge in oil prices.

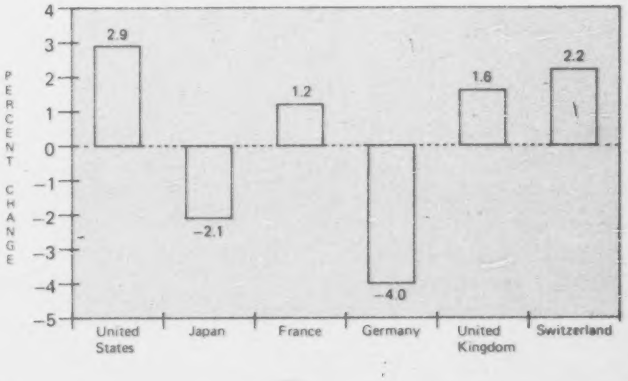
In the first quarter, however, each experienced a sizable drop in inflation-adjusted gross national product compared with quarter-earlier levels, with Germany's falling at a four percent annual rate and Japan's dropping at a 2.1 percent annual clip—the first quarter-over-quarter decline in Japanese real GNP since early 1975. What these developments have done, besides disappoint policymakers and economists alike, is again fuel expectations of another round of coordinated, industrial country interest rate reductions—a matter almost certain to be discussed at this week's Federal Open Market Committee meeting.

To be sure, the discussion will probably center on what went wrong, and what can be done about it. In Germany, for example, poor winter weather conditions negatively affected construction activity in the first quarter, while diminished domestic and foreign factory orders curbed industrial output. With respect to Japan, the strength of the yen has battered the economy, suppressing corporate profits, industrial production, investment activity and exports. In yen terms, overseas sales fell by nearly 14½ percent during the first five months of the year from their comparable 1985 levels. The decline in exports is a most significant development, as it was the external sector which had been the main prop of the economy in recent years. Domestic demand, in contrast, has remained weak. As in Germany, however, the Japanese government remains optimistic about future growth prospects—in sharp contrast to the gloomy assessment prevailing among private forecasters who predict a lackluster growth rate no higher than 2½ percent this year.

. . . Here And Abroad . . .

Elsewhere in the industrial world, the economic news is only slightly better, with export activity generally disappointing, investment activity weak and consumer spending soft. France's first quarter annualized growth rate, for instance, was a paltry 1.2 percent, the United Kingdom's was 1.6 percent, and Switzerland's was 2.2 percent (see chart). By comparison, the U.S. real GNP growth rate of 2.9 percent annualized would appear fairly satisfactory. However, several weak business statistics since then make it a good bet that economic growth slowed noticeably in the second quarter. What is more, the lackluster growth rates in the industrial world offer little confidence that the large number of unemployed will be reduced, particularly in Europe where double-digit rates prevail in several countries.

FIRST QUARTER 1986 REAL GNP GROWTH
IN SELECTED INDUSTRIAL COUNTRIES
(QUARTER-OVER-QUARTER AT ANNUAL RATES)



The sluggish economic performance in both the U.S. and overseas has sparked expectations that another round of coordinated interest rate cuts by the major industrial countries is imminent. Such expectations, in fact, have been fueling the rise of world stock markets in recent weeks with the U.S. and Japanese markets particularly buoyant. However, it is uncertain which country—the U.S., Germany or Japan—will lead the way. The Federal Reserve's policymakers, for example, may be somewhat reluctant to initiate another round of interest rate

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reductions because of rapid money growth as well as fears of precipitating a significant decline in the external value of the dollar.

What is more, with the trade deficit remaining large, the U.S. is eager for other nations to take the lead in stimulating economic activity, thus creating opportunities for hard-pressed U.S. exporters. The huge trade deficit has remained the Achilles heel of the economy, with the downward revision in first-quarter GNP due entirely to an increase in the originally estimated trade deficit. As a result, the U.S. Administration has been urging Germany and Japan to cut their interest rates in order to spur their domestic demand and thus encourage imports.

. . . Suggest Further Interest Rate Declines

Germany has hesitated to do so, however, because of the current weakness of the Deutschemark within the European Monetary System (EMS) and, as in the United States, above-target money supply growth. What is more, a snapback in retail sales, factory orders and industrial production during early spring has led some to suggest that further monetary stimulus is unnecessary. The Japanese also are wrestling with above-target money supply growth, and associated inflation rate fears. While this has not precluded previous discount rate cuts, there is a decided reluctance to move too far, too fast. However, the likelihood of continued economic sluggishness will probably tip the scales in favor of another round of discount rate cuts, with Japan

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit	6/25/86		
U.S. Gov'ts and Agencies Owned Outright & RPs	190.282	– 2.036	+15.270
Loans to Depository Inst.	.784	+ .050	+ .049
Float	.792	– .317	+ .478
Total Reserve Bank Credit	207.255	– 2.226	+19.203
Treasury Deposits with Federal Reserve Banks	3.428	+ .353	– .326
Currency in Circulation	198.429	– .439	+13.290
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	145.959	– 2.448	+24.200
	6/18/86		
Member Bank Reserves:			
Total Reserves Held	49.582	+ 1.744	+ 6.873
Excess (Deficiency)	.642	– .356	– .082
Net Free Reserves	.449	– .244	+ .236
		% Change Since Three Months Ago*	% Change Since Year Ago
Monetary Aggregates †			
M1 (6/23/86)	666.4	+ 18.3‡	+ 13.1‡
M2 (May '86)	2,646.9	+ 10.9	+ 7.9
M3 (May '86)	3,306.7	+ 8.3	+ 7.7
Domestic Nonfinancial Debt (1st Q'86)	7,033.5	+ 8.7	+ 14.2

†Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 7/3/86	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	5.94%	5.86%	5.91%
* Federal Agencies	6.23	6.13	6.08
* Municipal Notes—High Grade (46% Taxable Equivalent)	6.94	7.41	7.87
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	6.45	6.44	6.60

‡ Finance Company Paper—Prime

5- 14 days	6.75%
15- 29 days	6.70
30- 59 days	6.70
60- 89 days	6.60
90-179 days	6.55
180-239 days	6.35
240-270 days	6.35

‡* Bankers' Acceptances

Aug.	6.70%
Sep.	6.50
Oct.	6.40
Nov.	6.33
Dec.	6.30
Jan.	6.30

‡ Industrial Paper—Prime

30- 89 days	6.70%
90-120 days	6.55

†Federal Funds Effective Rate 6.90%

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	1st Q'86	$ 4,116	$ 4,059	$ 3,918
Gross National Product (1982 Dollars)*	1st Q'86	$ 3,617	$ 3,591	$ 3,548
Percent Change, Annual Rate	1st Q'86	2.9	0.7	3.7
Change in Consumer Prices*	May '86	2.4%	– 3.6%	2.4%
Change in Producer Prices*	May '86	7.2%	– 7.2%	2.4%
Civilian Employment (Thousands of Persons) †	Jun '86n	109,673	109,110	106,601
Unemployment as % of Civilian Labor Force †	Jun '86n	7.1%	7.3%	7.3%
Personal Income*	May '86	$ 3,445	$ 3,448	$ 3,271
Leading Indicators Composite Index (1967=100)†	May '86n	178.8	178.5r	167.1
Industrial Production Index (1977=100) †	May '86	124.2	125.0	124.1
Net Change in Consumer Installment Credit †	Apr '86	$ 4.16	$ 3.09	$ 7.54
U.S. Merchandise Trade Balance †	May '86n	–$ 14.21	–$ 14.28r	–$ 12.50
Plant and Equipment Expenditures*	3rd Q'86	$388.87(a)	$387.42(a)	$388.90
Private Housing Starts (Thousands of Units)*	May '86	1,888	2,039	1,684
New Construction Expenditures*	May '86n	$ 374.7	$ 371.6r	$ 352.0r
Total Business Inventories †	Apr '86	$ 590.2	$ 588.2	$ 578.5
Total Business Sales †	Apr '86	$ 426.3	$ 420.2	$ 423.2

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

most likely to lead the way after their July elections.

Whether or not further declines in interest rates in and of themselves will spark the economies of the industrial world is uncertain. Although nominal interest rates are already at their lowest level this decade, inflation-adjusted, or real interest rates remain at lofty heights. Still, Japan has reduced its discount rate from five percent at the end of last year to its present 3.5 percent, while in the U.S., the 30-year Treasury bond is at its lowest level since the late 1970s. In fact, one reason for the drop in interest rates, besides the collapse of inflationary expectations resulting from falling oil prices, is the ongoing weakness in the economies of the major countries.

A partial explanation for this lingering malaise lies with the stance of some governments' fiscal policies. With the notable exception of the United States, most governments have refused to adopt stimulative policies to reinforce the easing of their monetary policies, and have instead continued to pare their budget deficits. They apparently believe that the boost to real purchasing power arising from low inflation rates, low nominal interest rates, and falling oil prices will be sufficient to prompt faster growth. However, high real interest rates continue to retard business activity in general, and the energy price decline has so far produced more minuses than pluses in terms of output, employment and capital spending, suggesting that this could be another subdued year for the global economy—and that interest rates may move lower still. H

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (6/18/86)	154,364	– 724	– 1,488
New York City (6/18/86)	34,003	– 425	+ 1,309
Commercial Paper (6/18/86)	317,241	+ 5,233	+56,607

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (6/18/86)	258,908	– 277	+ 3,876
New York City (6/18/86)	56,251	– 352	– 4,994

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (6/18/86)	736,630	+ 1,262	+ 50,648
New York City (6/18/86)	159,195	– 43	+ 4,118

Financial Markets

	Thursday 7/3/86	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	6.05%	– .15	– .94
180-Day Bills†	6.08	– .19	– 1.04
Longest Bills†	6.24	– .20	– 1.13
Recent Issues:			
7s 6/30/88	6.64	– .19	
7¼s 3/31/90	7.02	– .13	
7⅜s 5/15/96	7.29	– .09	
7¼s 5/15/16	7.16	– .13	
Municipals:			
Bond Buyer–20 Bond Index* (7/2/86)	7.51%	– .08	– 1.31
Blue List Total ($ Million)	$1,874	–$ 165	– $ 29
30-Day Visible Supply ($ Million)	$4,408	+$1,360	+ $ 663
Total	$6,282	+$1,195	+ $ 634
Corporates:			
Moody's Aa Composite (7/1/86)	9.31%	– .04	– 2.15
30-Day Visible Supply ($ Million)	$3,725	+$ 820	+ $1,927
Stocks:			
Dow-Jones Averages:			
Industrials	1,900.87	+ 15.61	+ 565.18
Transportation	777.75	+ .25	+ 99.50
Utilities	200.76	+ 1.98	+ 34.42
65 Stocks	727.91	+ 4.63	+ 172.51
N.Y.S.E. Composite Index	144.67	+ 1.49	+ 33.03
N.Y.S.E. Avg. Daily Vol. for Week (000's)	135,278	+ 4,780	+ 45,688

* 46% Taxable equivalent 13.91%.

† Bond equivalent

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Thursday 7/3/86	Week Ago
Overnight	6.94%	6.88%
1 month	6.88	6.94
3 month	6.81	6.81
6 month	6.81	6.81
1 year	6.88	6.88
EURODOLLAR BONDS Average Yield		
Medium Term (5 to 7 yrs.)	7.67%	7.10%
Long Term (7 to 15 yrs.)	8.24	7.50

FOREIGN EXCHANGE SPOT RATES

New York Opening (7/3/86)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02251	44.43
Canada	.7257	1.3780
Denmark	.1240	8.0675
France	.1443	6.9300
Germany	.4607	2.1708
Italy	.0006709	1490.50
Japan	.006184	161.70
Mexico	.001552	644.50
Netherlands	.4089	2.4455
Switzerland	.5663	1.7660
U.K.	1.5460	.6468

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